

Prospects for the U.S. International Travel Deficit

Travel is an important part of U S international trade that has posted record deficits in recent years. From a position of near balance in 1981, the travel and tourism account approached a \$10 billion deficit in 1985 (Table 1). Analysis of past experience confirms that travel flows are heavily influenced by the same factors that determine merchandise trade—in particular, the deterioration in the U S travel balance during the 1980s is largely attributable to the strong dollar and rapid real growth relative to abroad. Though the dollar's recent decline against the Japanese yen and major European currencies should significantly lower the merchandise trade deficit over the next several years, it is likely to lead to only a modest improvement in the travel balance—probably no more than \$3 billion from economic factors alone. This is because the dollar has not fallen against the currencies of our primary travel partners, Canada and Mexico.

The travel account measures spending by foreign visitors to America and by U S travelers abroad on items such as food, lodging, transportation, and entertainment. In 1985, foreign visitors spent a total of \$14 billion here while U S travelers spent \$24 billion abroad, amounts that represent about 7 percent of U S merchandise exports and imports respectively. The travel deficit was about 8 percent of the 1985 U S current account deficit and accounted for almost half of the \$20 billion deterioration in the U S services balance from 1981 to 1985.

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One important difference between U S travel and merchandise trade is their regional compositions. The Western Hemisphere's share of U S travel is 53 percent, considerably more than its 37 percent share of our merchandise trade (Table 2) Mexico alone accounts for 20 percent of overall travel trade, but only 6 percent of merchandise trade In contrast, Japan accounts for a hefty 16 percent of U S merchandise trade, but only 7 percent of total travel expenditures As explained later, these regional differences suggest that the recent decline in the dollar is effectively much less for U S travel than for merchandise trade

Historical perspective

As with U S trade generally, changes in the travel balance are largely explained by relative income growth and exchange rate movements Rising incomes increase demand for most goods and services, including travel¹ Travel expenditures are also sensitive to relative cost considerations and hence changes in exchange rates A decline in the dollar tends to raise the cost of overseas travel for U S citizens and makes the United States more attractive to visitors from the rest of the world Prior studies suggest that a 1 percent decline in the dollar can be expected to increase travel receipts

¹See, for instance, prior work by Jacques Artus, "An Econometric Analysis of International Travel," *IMF Staff Papers* (1972), pages 579-614, Jane S Little, "International Travel in the U S Balance of Payments," *New England Economic Review* (May/June 1980), pages 42-55, and Jeffrey Rosensweig, "The Dollar and the U S Travel Deficit," *Economic Review*, Federal Reserve Bank of Atlanta (October 1985), pages 4-13 Their findings suggest that a 1 percent rise in a country's real GNP can be expected to raise its travel expenditures by somewhat more than 1 percent

Table 1

International Travel and Passenger Fare Transactions

In billions of dollars

	1977	1981	1985
Total travel payments (-)	10.2	16.0	23.8
Passenger fares	2.7	4.5	7.3
Payments by U S travelers in foreign countries	7.5	11.5	16.5
Total travel receipts	7.2	15.5	14.1
Passenger fares	1.0	2.6	2.5
Receipts from foreign travelers in the United States	6.2	12.9	11.6
Net travel and passenger payment deficit	3.0	0.5	9.7
Memo			
U S current account balance	-14.5*	6.3	-117.8*

*Indicates deficit

from abroad by somewhat more than 1 percent and to reduce travel expenditures by U.S. citizens by less than 1 percent ²

Examination of the experience of the past decade illustrates the response of the travel balance to exchange rate movements and real growth here and abroad (Chart 1). From 1977 to 1981 the travel deficit declined from \$3 billion to \$0.5 billion. Although the United States grew, on average, at a rate close to that of other industrial nations, the travel account improved, largely due to a 15 percent fall in the value of the dollar against the currencies of our major travel partners during this period ³ The deterioration in the travel deficit since 1981 can be attributed, in large measure, to the dollar's appreciation (over 30 percent on both a travel- and trade-weighted basis through mid-1985) and to faster real growth in the United States than abroad. From 1981 to 1985, total receipts from foreign travelers declined by almost 10 percent while expenditures by U.S. travelers abroad rose 44 percent.

Developments in our bilateral travel flows since the late 1970s provide further evidence of how sensitive the travel balance is to exchange rate movements and real growth. Between 1977 and 1981, the U.S. travel deficit showed significant improvement with all major partners

²Dollar depreciation will normally lower the dollar value of travel payments less than proportionately. The resulting decline in real expenditures by U.S. travelers is partially offset by the rise in the dollar prices paid for food, lodging, and other items while abroad. On the other hand, the effect of increased real expenditures by foreign travelers to the United States as a result of the falling dollar is reinforced by any rise in the dollar prices paid.

³The weights for the travel-weighted dollar index computed for this article are bilateral shares in U.S. travel trade of eight major travel partners: Canada, Mexico, the United Kingdom, France, Germany, Italy, Japan, and the Bahamas. The index is in real terms, that is with exchange rates adjusted by indexes of relative national price levels.

whose currencies appreciated against the dollar (Germany, the United Kingdom, Japan, and Mexico). At the same time, our balance with Canada, whose currency depreciated against the U.S. dollar, deteriorated.

The worldwide appreciation of the dollar over 1981-85 accompanied a deterioration in our major bilateral travel balances, as U.S. citizens stepped up their travel throughout the world. In contrast to the general pattern, however, our bilateral balance with Japan improved, partly because Japan grew somewhat more rapidly (on average) than the U.S. over this period, and because the yen depreciated less against the dollar than the major European currencies did.

Our travel balance with Mexico is particularly sensitive to exchange rate movements because residents along the border can readily cross the boundary to shop. (Indeed, such spending amounts to over 50 percent of the two countries' bilateral travel trade.) As a result, a *real* appreciation of the peso combined with rapid Mexican growth produced a \$1.6 billion improvement in our bilateral balance from 1977 to 1981. The subsequent sharp rise in the dollar's real value during 1982-83 led to a \$2.6 billion decline in this balance. In the next two years our bilateral deficit changed little as an appreciation of the peso through mid-1985 apparently offset the effects of a weakening Mexican economy.

Prospects

Looking ahead, prospects for improvement in the U.S. travel deficit seem limited because the dollar's depreciation has been much less uniform than its prior appreciation. The dollar declined approximately 30 percent in real terms against the currencies of West Germany and Japan between the second quarters of 1985 and 1986. However, it has maintained its average value in relation to Western Hemisphere currencies, in

Table 2

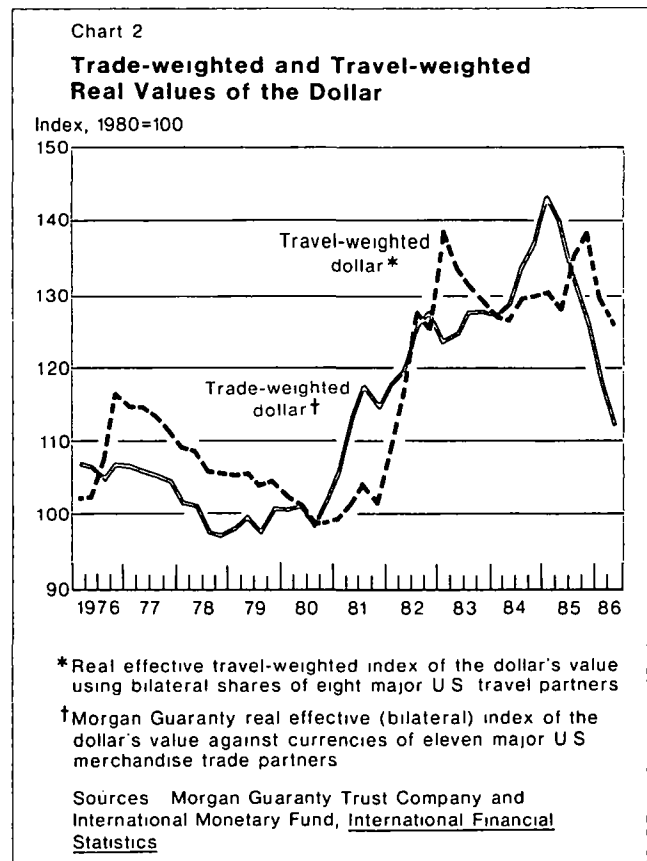
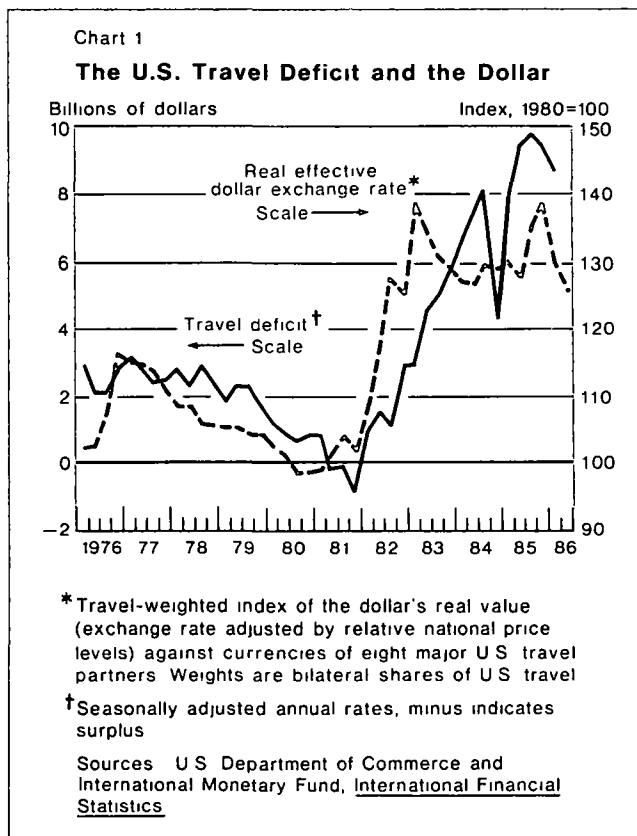
Regional Distribution of the U.S. Travel Balance: 1985 (excludes passenger fares)

In billions of dollars

	Travel payments	Travel receipts	Net balance	Percent share of U.S. travel trade*	Percent share of U.S. merchandise trade†
Western Hemisphere	8.4	6.5	-1.9	53	37
Canada	2.7	3.0	0.3	20	23
Mexico	3.6	2.0	-1.6	20	6
Caribbean and Central America	1.8	0.6	-1.2	9	2
Western Europe	5.9	2.3	-3.6	29	24
Japan	0.5	1.4	0.9	7	16

*Bilateral shares of U.S. travel flows (receipts plus payments, excluding passenger fares)

†Bilateral shares of U.S. merchandise trade (exports plus imports)



fact, the dollar has appreciated sharply against the Mexican peso. As a result, the real value of the dollar has fallen only 6 percent from last year's average on a travel-weighted basis. This is significantly less than its decline during 1977-81 and reverses only about one-fifth of its rise since 1981. In contrast, the trade-weighted dollar has declined substantially, offsetting more than one-half of its prior rise as measured by most published indexes (Chart 2).

The extent to which the travel balance responds to the dollar's decline depends on the pace of real growth here and abroad. Assuming that the United States and other industrial nations grow at close to their potential rates (which implies increases in domestic demand growth rates abroad compared with the average of recent years), we could expect a modest decline of \$1.5 to \$3.0 billion in the travel deficit over the coming two years.⁴ Most

⁴Underlying this analysis is the assumption that real travel expenditures have an elasticity of roughly 1.5 relative to income growth and real exchange rate movements.

of this decline should result from increased visits to the United States, particularly from Western Europe and Japan. Travel receipts might increase by as much as 20 percent annually over this period, spending by U.S. citizens abroad is likely to continue to increase, but at a slower rate than in recent years.

Of course, the actual improvement in the travel balance may differ significantly from this estimate, depending on a variety of factors that are difficult to predict. For example, a pickup in foreign relative to U.S. growth would probably result in further improvement of the travel balance. Political factors also can be important influences on travel flows. In particular, recent events suggest that concerns over terrorism could significantly reduce U.S. travel abroad this year and next. If so, the decline in the travel deficit may be substantially greater than economic factors alone would suggest—although modest, in any case, in relation to the overall current account deficit (presently over \$120 billion annually).

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